DOCKET FILE COPY ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Implementation of Sections of	)	
the Cable Television Consumer	)	MM Docket No. 92-266
Protection and Competition Act	)	
of 1992	)	
	)	
Rate Regulation	)	

To: The Commission

COMMENTS OF COALITION OF SMALL SYSTEM OPERATORS

Gardner F. Gillespie
Jacqueline P. Cleary

Hogan & Hartson
555 13th Street, N.W.
Washington, DC 20004-1109
202/637-5600

Attorneys for the Coalition of
Small System Operators

Dated: August 31, 1993

No. of Copies rec'd 0+9
List ABCDE

\\\DC\62354\0001\PL001701.DOC

TABLE OF CONTENTS

SUMMARY

The FCC cannot ignore the plain language of the statute, that clearly expresses Congress' intent to provide relief from administrative burdens and costs for all systems with 1,000 or fewer subscribers. In view of the unambiguous statutory language, the FCC does not have discretion to modify, qualify or restrict the application of this Congressional mandate by excluding small systems with fewer than 1,000 subscribers based on their ownership. Nor does the record of this proceeding contain any indication that either the costs or the administrative burdens of regulation impact more severely on independently owned systems than systems owned by MSOs.

There are also strong policy reasons for providing administrative relief to all small systems, regardless of ownership. Deregulation in the mid-1980s provided small cable companies with the necessary flexibility to bring cable television service to sparsely populated rural areas. Many of these small companies purchased clusters of systems and established a central office serving multiple systems to maximize efficiency. The FCC must not penalize these small system operators that have brought service to outlying areas, just because they own more than one system. Even though common ownership provides some needed efficiencies for these operators, they still suffer from the same problems as independently owned small systems, such as low subscriber density, lack of substantial programming discounts and lack of financial leverage. When the enormous administrative burdens of

operating multiple headends are added to this equation, it becomes clear that these systems must be deemed "small systems" for purposes of rate regulation.

The definition of "small systems" also must take into account that the cable industry is moving toward technical interconnection and consolidation of ownership in anticipation of its role in developing an interconnected, nationwide information highway. The efficiencies of interconnection and consolidation of ownership also will enable traditional cable operators to compete more effectively with DBS. So as not to discourage the benefits of interconnection and consolidation, the FCC's definition of "small system" should be based on the number of subscribers in a given franchise area, rather than the number of subscribers served by a technically integrated system. A franchise area-based definition will promote improved service through interconnection and consolidation of ownership, and should therefore be adopted.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	)))))))	MM Docket No. 92-266

To: The Commission

COMMENTS OF COALITION OF SMALL SYSTEM OPERATORS

On behalf of the Coalition of Small System Operators, 1/ we hereby urge the Commission to adopt a definition of "small system" that

---

1/ The Coalition of Small System Operators consists of: ACI Management, Inc.; Balkin Cable; Buford Television, Inc.; Classic Cable; Community Communications Co.; Douglas Communications Corp. II; Fanch Communications, Inc.; Frederick Cablevision, Inc.; Galaxy Cablevision; Harmon Communications Corp.; Horizon Cablevision, Inc.; Leonard Communications, Inc.; Midamerican Cable Systems, Limited Partnership; Mid-American Cable Television Association; Midcontinent Media, Inc.; Mission Cable Company, L.P.; MW1 Cablesystems, Inc.; National Cable Television Cooperative, Inc.; Phoenix Cable, Inc.; Rigel Communications, Inc.; Schurz Communications, Inc.; Star Cable Associates; Triax Communications Co.; USA Cablesystems, Inc.; and Vantage Cable Associates. Coalition members own and operate approximately 2,784 headends (representing more than a quarter of the headends in the country), serving approximately 1,297,856 subscribers. Coalition member Mid-American is an association of cable operators serving 1,458,644 subscribers in 1,479 communities located in Kansas, Missouri, Nebraska and Oklahoma. The members of Mid-America have

[Footnote continued]

includes systems with less than 1,000 subscribers, regardless of ownership. Furthermore, the definition should focus on the number of subscribers in a given franchise area, rather than the number of subscribers to a technically integrated system, which may serve subscribers in a dozen franchise areas.

The Coalition members suffer the high costs and enormous administrative burdens associated with the operation of numerous headends, each serving a small number of subscribers in one or more communities. Coalition members also are generally unable to glean substantial economies such as programming discounts and favorable financing rates. Small systems that are owned by small-to-medium sized multiple system operators suffer from many of the same high costs and disproportionate administrative burdens as independent, stand-alone systems, except that in the case of small system MSOs, the administrative burdens are multiplied by the number of headends and the number of different franchise areas with regulatory jurisdiction.

Small system MSOs were virtually non-existent before deregulation of the cable industry in the mid-1980s. Deregulation made it

---

[Footnote continued]

918 systems with less than 1,000 subscribers. The National Cable Television Cooperative is a purchasing cooperative which represents 360 small and mid-size independent cable companies. These companies together serve more than 2.8 million subscribers in over 2,300 communities nationwide. A chart describing the Small System Operators is attached as Exhibit 1.

economically feasible for companies to provide service to low density rural areas. In order to continue to provide high quality service to rural areas, small MSOs must be given some relief from the administrative burdens and costs of rate regulation.

I. THE STATUTE REQUIRES A DEFINITION OF "SMALL SYSTEMS" THAT WILL INCLUDE ALL SYSTEMS WITH 1,000 OR FEWER SUBSCRIBERS

Congress clearly provided that systems with 1,000 or fewer subscribers should receive relief from administrative burdens imposed by the FCC with respect to rate regulation. Neither the plain language of the statute nor the legislative history of the 1992 Cable Act provides any reason to believe that the FCC has discretion to qualify this definition by limiting those systems with 1,000 or fewer subscribers entitled to relief from administrative burdens. The opposite is true. The intent of Congress here is plainly expressed in the language of the statute:

> In developing and prescribing regulations pursuant to this section, the Commission shall design such regulations to reduce the administrative burdens and cost of compliance <u>for cable systems that have 1,000 or fewer subscribers</u>.

Cable Television Consumer Protection and Competition Act, Pub. Law No. 102-285, 106 Stat. 1460 (1992), Section 623(i) (emphasis added).

Where, as here, statutory language is clear on its face, there is no room for agency interpretation. <u>See</u>, <u>e.g.</u>, <u>American Civil Liberties Union v. FCC</u>, 823 F.2d 1554, 1567-68 (D.C. Cir. 1987). It is only where

"Congress' intent is 'silent or ambiguous'" that it is appropriate to "consider . . . the agency's construction." Id. at 1567, citing Chevron, USA v. NRDC, 467 U.S. 837, 842-43 (1984). Moreover, when developing its rules, the FCC must "not deviate from or ignore the ascertainable legislative intent". Greater Boston Television Corp. v. FCC, 444 F.2d 841, 850 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971). For the FCC to adopt a rule that contradicts plain language in the statute would ignore the bedrock precept that an agency's decisionmaking must be "true to the congressional mandate from which it derives authority." Farmers Union Cent. Exchange, Inc. v. FERC, 734 F.2d 1486, 1500 (D.C. Cir. 1984). The Commission cannot inject its own interpretation into a provision that Congress stated unambiguously. To do so would be to ignore the clear Congressional mandate that the FCC must provide relief from administrative burdens and costs for all small systems with 1,000 or fewer subscribers.

Congress' intent to include small system MSOs in any relief for systems with 1,000 or fewer subscribers is also evident in letters from Senators and Congressmen to the FCC. For example, by letter to Chairman Quello dated March 5, 1993, Sen. Larry Pressler, Sen. Tom Daschle and Sen. Tim Johnson (attached as Exhibit 2) specifically recognized the "economics stemming from acquiring geographically clustered systems," and supported small system relief for MSOs that took advantage of those economics. In another letter to the FCC dated May 25, 1993 (attached as Exhibit 3), Congressman Alex McMillan commended smaller companies that "pioneered the expansion of cable service into low density areas." Rep. McMillan cited the high fixed costs and limited subscriber bases generally experienced by smaller cable companies in support of relief from administrative costs and burdens for small systems. Rep. McMillan's very detailed letter does not cite ownership of a given system as a factor for evaluating whether small system relief is appropriate. The same is true for a letter dated July 21, 1993, signed by Senators Dole, Packwood, Burns, Stevens, Pressler, McCain, Wallop, Lott, Shelby, Simpson and Brown (attached as Exhibit 4). These Senators question the FCC's failure to provide relief from administrative costs and burdens for small systems with 1,000 subscribers or less. They do not give any indication that this relief should be restricted to independently owned systems.

II. THE RECORD LACKS ANY EVIDENCE TO SUPPORT DIFFERENT TREATMENT FOR INDEPENDENTLY OWNED SMALL SYSTEMS

There is no evidence whatsoever in the record to support different treatment for independently owned systems versus systems owned by MSOs. The FCC's record in the captioned proceeding does not provide any reason to believe that administrative burdens and costs are higher for independently owned systems than affiliated systems. The Small System Operators have provided information with respect to their high costs. But there is no information from independently owned systems with which to compare it. Furthermore, any such comparison would be meaningless unless it took into account density as well as system size.

It is entirely possible that the multiple small system operators serve lower density areas than independently owned systems. It is also possible that small systems owned by MSOs serve fewer subscribers per system than independently owned systems. The fact that these two uncertainties exist -- and, absent a statistically reliable survey of affiliated and independent small systems, will continue to be unresolved -- requires equal treatment for <u>all</u> small systems. The FCC cannot depart from clear statutory language to accommodate the theory that independent operators have higher costs than affiliated systems when that theory is not supported by the record.

III. ADMINISTRATIVE BURDENS IMPACT EVEN MORE HEAVILY ON SMALL SYSTEM OPERATORS WITH MULTIPLE HEADENDS THAN INDEPENDENT, STAND-ALONE SYSTEMS

Most of the technically integrated systems operated by the Small System Operators serve less than 1,000 subscribers. Of these small systems, many serve less than 500 subscribers. Indeed, for the 2,559 headends with less than 1,000 subscribers operated by members of the Coalition, the <u>average</u> number of subscribers is 347. The administrative burdens and costs of implementing the new signal carriage, technical, customer service, and rate rules on these systems cannot be overstated.

A. The Procedures for Implementing Rate Regulation Impose Extraordinary Administrative Burdens On Operators of Multiple Small Systems

The ability of individual franchise authorities to regulate rates, combined with the requirement that systems analyze their rates at the franchise level for comparison with benchmarks, impacts heavily on small system MSOs because of the structure of their operations. The Small System Operators tend to operate multiple headends, spread over large geographic areas, with each headend serving multiple franchise areas. Every single franchise area where a given Small System Operator has a subscriber could require the submission of a Form 393 or a cost-of-service analysis. The burden of completing these Forms may not be great for a metropolitan-area cable system serving one or two franchise areas, but it is staggering for small system operators, whose sprawling rural systems may serve a dozen franchise areas.

Of course, the administrative costs of rate regulation per subscriber are also much higher for smaller systems. The estimated 40-hour preparation time for a Form 393 in a metropolitan franchise area with 50,000 subscribers would take about three seconds per subscriber. In sharp contrast, the preparation time for the average small system of the Coalition members (347 subscribers) would be about six minutes per subscriber. For a 50-subscriber system, the Form would take about 48 minutes per subscriber. This extraordinary difference between the per subscriber burden for small systems and the per subscriber burden for larger systems is exacerbated by the fact that the small system operators have so many franchise areas, each with a small number of subscribers.

Management of these small, far flung systems is generally conducted on a consolidated basis from a centralized location. Accounting and bookkeeping also is generally done on a consolidated basis for clusters of systems, or at least at the system rather than the franchise level. The requirement that rates be analyzed at the franchise level will require that the small systems' accountants create what amounts to a whole new set of books at the franchise level. By requiring that rates be analyzed at the franchise level and by the franchise authorities, the FCC has gone far (inadvertently) to chip away at the Small System Operators' ability to realize efficiencies by consolidating the management and accounting functions for small systems. Because small system MSOs would be forced under the current regulatory structure to face rate regulation by every burg and bend in the road where they have a franchise agreement, the burdens of the new regulations impact far more severely on them than on large, metropolitan operators with one or two franchise areas served by each system.

As an illustration of the seriousness of the impact of these new rules on small system MSOs, Douglas Communications Corp. II operates systems in 494 franchise areas serving a total of 103,090 subscribers, an average of 208 subscribers in each franchise area. Before the effectiveness of rate regulation was stayed for small systems, Douglas was expected to complete 494 separate Form 393s -- one per franchise area. When the rules ultimately take effect, Douglas' basic rates will be subject to regulation by 494 franchise areas, each of which will be required to adopt its own rules. The cost of completing the Form

393s for each franchise area is by itself extraordinary. Assuming that each Form takes 40 hours to complete (as estimated by the FCC), and assuming that the Forms could be completed by a person paid $20.00 per hour (a very conservative assumption based on Douglas' experience), the personnel cost of completing one Form for each franchise area would be $395,200. In addition, it would take one person working full-time about a year-and-a-half to complete the Forms. In order to have devoted 40 hours apiece to the Forms, and to have completed the Forms by September 1, Douglas would have been required to use 30 full-time employees. There are only nine people currently employed in Douglas' headquarters office where the benchmark analyses must be conducted.

After the initial benchmark calculations are complete, Douglas will be required to evaluate whether to lower rates to the benchmark level, change service offerings to increase permissible rate levels, restructure tiers and equipment charges to come into compliance with benchmarks, or rely on cost-of-service standards which will likely require detailed analyses at the local franchise level and the FCC to justify existing above-benchmark rates. If Douglas determines that it simply cannot bring its basic and tier rates into line with the benchmarks, it could be required to prepare cost-of-service analyses for each franchise area and also for its regulated tier rates at the FCC. 2/

2/ Douglas relies primarily on the basic tier for revenue. As with many of the other Small System Operators, Douglas offers only the basic tier in many of its systems. Also, by and large, Douglas lacks the technical wherewithal to offer pay-per-view programming or local advertising

[Footnote continued]

The following chart, based on a random sample of Small System Operators, illustrates some of the problems that these small systems will have if they are not included in "small system" relief:

BURDENS IMPOSED BY RATE REGULATION

COMPANY NAME	# FORM 393 REQUIRED	STAFF TIME DEVOTED TO 393	# FRANCHISE AUTHORITIES ALREADY HAD DISCUSSION RE RATE REG	# COST OF SERVICE SHOWINGS PLANNED
HORIZON CABLE	81	10%	40	20
CLASSIC CABLE	82	50%	82	UNKNOWN
DOUGLAS COMMUNICATIONS				
USA/MW1 CABLESYSTEMS	400+	15% (OF ADMIN STAFF)	NOT AVAILABLE	419
WESTERN CABLED SYSTEMS	13	NOT AVAILABLE	9	3-5
FANCH COMMUNICATIONS	494	35%	100+	UNKNOWN
STAR CABLE	167	NOT AVAILABLE	MOST	MOST
VANTAGE CABLE	117	10%	15-20	UNKNOWN

[Footnote continued]

inserts. Unlike the larger MSOs, therefore, the Small System Operators are dependent on basic and expanded basic tiers for almost all of their revenues. This high level of dependency on basic rates limits the Small System Operators' ability to reduce these rates to benchmark levels.

The typical practice of small MSOs to serve large geographic areas from a single office will present enormous logistical problems with respect to the implementation of rate regulation. Douglas has an office in Topeka, Kansas, that serves subscribers in Kansas, Missouri, Nebraska, Iowa and Illinois. There are 295 headends and approximately 60,000 subscribers served by this office, for an average of 203 subscribers per headend. It would be impossible for Douglas to meet with representatives from each of the 323 franchise areas served by this office to discuss rate regulation, both because of the large number of franchises and the substantial distances between the office and many of the franchise areas. To the extent that these franchise areas seek to regulate rates, it is unclear how Douglas will be able to have representatives present at their meetings.

Based on the experiences of the Small System Operators, the burdens of evaluating compliance and implementing the new rate rules impact disproportionately on operators with many small systems. That these systems are owned jointly with other cable systems only magnifies the burdens of compliance. The hundreds of analyses and the many changes required by the rate rules will be even more difficult for small system MSOs than independently owned systems in many instances because the small system MSOs tend to have more streamlined, centralized facilities with fewer employees available to devote to regulatory compliance. Small system MSOs should be included in the definition of "small system" so that they can benefit from any small system relief from administrative burdens and costs provided by the Commission to "small systems."

B. Small System Operators Are Already Struggling to Keep Up With Administrative Burdens and Costs Imposed By Other New Regulations

The burden of assimilating the new rules has been huge for the Small System Operators, most of which do not have in-house lawyers to digest and interpret the new rules. Since the 1992 Cable Act became law, there have been 1,361 pages of new regulations issued by the FCC with respect to cable issues. Some of the new rules -- particularly the signal carriage rules and rate regulations -- are extremely complicated and time-consuming to administer. These rules must be handled by high-level personnel, who must spend less time on their regular duties to accommodate the work required by the new rules.

Even before the effectiveness of rate regulation, small system operators are struggling to deal with the many other new regulations imposed by the Commission during the last year. For example, of the nine people in Douglas' headquarters office, one person has done nothing but work on with signal carriage issues since April 1993, one person has been occupied about 30 percent of the time with signal carriage issues, and a temporary office assistant was hired for about one month to assist with the massive administrative task of preparing and sending by certified mail the hundreds of notifications required to be sent to broadcast stations. In addition, personnel at each of Douglas' regional offices have invested a substantial amount of time evaluating the validity of must-carry requests, assisting with the notifications to broadcast stations, assessing and implementing the technical changes necessary to add and reposition channels, and negotiating retransmission consent with local broadcast stations.

As a result of the new signal carriage rules, Douglas sent out 157 signal deficiency notices to broadcast stations. Douglas also sent 324 notices to broadcasters describing channel line-ups at its 437 systems, as required by the signal carriage rules, at certified mail costs of about $1,000. Before October 6, 1993, Douglas will either conclude about 124 sets of retransmission consent negotiations with broadcast stations already carried on its systems, or take the stations off the systems, leaving blank screens for its subscribers. Retransmission consent negotiations for multiple small system owners have been extremely difficult owing in part to their inability to pay for broadcast signals or to add a new channel, such as ESPN II, as each of the networks has requested. The larger operators and very small operators may be able to add a new channel throughout their entire systems, but the Small System Operators would have to add the new channel to so many headends to meet contractually required subscriber penetration levels that this alternative to cash payments is out of the question. Adding to the burdens of the signal carriage rules, negotiations are also required for some of the must-carry stations that specified a preferred channel position, but wish to negotiate for a different channel position (typically in exchange for reduced consideration for carriage of the station in a nearby system where the station elected to be carried pursuant to retransmission consent).

To add <u>each</u> of the 110 channels that requested must-carriage, it will cost Douglas about $1,080 (for a total of $118,800) in headend equipment costs alone. This figure does include technicians' time spent to complete the installations, or any of the administrative time spent on the logistics of the channel additions and repositioning. And again, the efficiencies that the Small System Operators have been able to take advantage of by consolidating operations cannot be utilized in this context because these must-carry stations must be added to headends throughout a large geographic area -- in Douglas' case, from Nebraska, to Texas, to Illinois.

Another of the Small System Operators, Star Cable Associates, faces similar problems. Star provides service to 167 franchise areas from 62 headends, with an average of 360 subscribers in each franchise area. Star has been required to add a total of 64 television broadcast stations to its channel line-ups due to the stations' election of must-carry. One of Star's very small systems with just 90 subscribers was required to add four must-carry stations to its line-up, at a cost of $4,800 in headend costs alone -- $53 per subscriber. For each of Star's systems, every single broadcast station's must-carry request had to be examined to determine whether the broadcaster, in fact, had must-carry rights. This process had to be conducted by personnel familiar with the new signal carriage rules. The personnel also had to have a working knowledge of copyright rules (in order to provide notification to stations whose carriage would result in an increase in copyright liability for a given system.) Engineers also had to be involved in order to evaluate signal strength of certain broadcast stations. In addition, consultations with FCC lawyers were required on many occasions in order to double-check rules and draft various letters and notifications. When the analysis was complete, the headend equipment required to add the 64 new channels cost approximately $76,800, exclusive of the substantial personnel costs and other overhead costs required to complete the channel additions. Star is now in the process of negotiating with 31 television broadcast stations for retransmission consent. If consent is not received by October 6, 1993, Star will be required to take these stations off of its systems.

Another small system operator, MW1/USA Cablesystems serves a total of 37,334 subscribers in 444 communities. MW1/USA estimates that the cost of complying with the new signal carriage rules alone will be about $843,700, or $22.20 per subscriber. A breakdown of these estimated costs is attached as Exhibit 5 hereto. In addition to the enormous cost of complying with the new signal carriage rules, the administrative costs of complying with the Commission's new rate regulations could be staggering. If the Commission does not adopt a streamlined procedure for small systems, because of its high costs and small subscriber base from which to recover those costs, MW1/USA Cablesystems will have no choice but to rely on cost-of-service analyses in each of the 419 franchise areas where it serves subscribers.

The following chart, based on a sample of Small System Operators, illustrates the substantial administrative burdens and costs imposed on them by the new signal carriage rules:

BURDENS IMPOSED BY SIGNAL CARRIAGE RULES

COMPANY NAME	TOTAL HEADENDS	MUST-CARRY STATIONS TO BE ADDED	NOTICES SENT TO BROADCAST STATIONS	NUMBER OF RETRANS NEGOTIATIONS	PERCENT OF STAFF TIME USED ON SIGNAL CARRIAGE ISSUES SINCE APRIL	COST OF EQUIPMENT NECESSARY FOR COMPLIANCE WITH SIGNAL CARRIAGE RULES
HORIZON CABLE	16	13	292	17	16%	$35,000
CLASSIC CABLE	73	0	410	36	75%	N/A
DOUGLAS CABLE	437	110	476	124	25%	$118,800
USA/MW1 CABLESYSTEMS	443	565	2,000	175	22%	$706,250
WESTERN CABLED SYSTEMS	29	0	132	9	N/A	N/A
FANCH COMMUNICATIONS	306	135	3,980	100+	14%	$121,500
VANTAGE CABLE	126	14	270	35-40	33%	$76,800
STAR CABLE	62	64	14.8	31	15%	$7,000

Other new FCC rules also have been expensive for small MSOs to implement. Horizon Cablevision, for example, which serves approximately 23,347 subscribers in 81 franchise areas (with an average of 288 subscribers in each franchise area), has had to substantially increase its staff and upgrade equipment to meet the new customer service standards. To comply with installation, repair and maintenance deadlines, Horizon has hired three new technicians ($25,000 each per year); added three service vehicles ($55,000 total); purchased eight cellular telephones for technicians ($3,500 total purchase price, which does not include the approximately $1,000 monthly service charge); and hired a dispatcher ($23,000 per year). Horizon also had to replace its phone system ($22,000) and purchase an automatic response unit ($19,000) to meet telephone answering requirements imposed by the new rules. This amounts to a total of $197,500 in costs directly attributable to compliance with new customer service standards.

IV. SMALL SYSTEM OPERATORS HAVE HIGH PER SUBSCRIBER COSTS AND DO NOT BENEFIT FROM LEVERAGE OR PROGRAMMING DISCOUNTS ON THE SAME LEVEL AS LARGE MSOS

Operators with multiple small systems generally suffer from the same cost-related problems as independently owned small systems. Both have limited subscriber bases from which to recover their costs of construction and operation. Even though the Small System Operators serve an average of 61,480 total subscribers, the average franchise area for the Small System Operators serves only about 333 subscribers. Small System MSOs experience no meaningful savings in construction costs in comparison with independent operators. The fixed cost of building plant in a given franchise area is spread over only a small number of subscribers, regardless of the system's ownership. Small system MSOs and independent systems face the same construction costs and should be treated the same.

Small systems also have higher operating costs per subscriber than large systems, regardless of ownership. For example, the operation from multiple headends serving a small number of subscribers can greatly increase construction and operating costs. Douglas has about 60,000 subscribers served from 295 headends and one centralized office. Douglas estimates that the cost of adding a single channel of programming is $1,080. To add the required must-carry channels to all of the systems served by this office would cost approximately $239,760, or $4.00 per subscriber. A breakdown of the expenses included in this estimate is attached as Exhibit 6. By contrast, adding the same channel to a single suburban system serving 60,000 subscribers from a single headend would cost only about $.02 a subscriber. The extra expense for the small system MSO to add a single channel to its line-up is one example why smaller MSOs warrant special treatment.

Administrative costs for smaller systems are also disproportionately higher than those incurred by larger systems. One Small System Operator estimates that, under deregulation, it was required to prepare and file approximately 4,250 separate reports each year with governmental entities for its 416 systems, which serve 304,734 subscribers. This amounts to one report for each 72 subscribers. If all of the Small System Operators filed the same number of annual filings, they would submit an aggregate of 22,582 reports, for an average of one report for each 39 subscribers. By contrast, based on the number of annual filings per system reported by the Small System Operator, a large operator with a single system of 304,000 subscribers would have to make only 10.2 annual filings, or one report for each 29,803 subscribers.

The small, scattered systems must also deal with many more franchise authorities. One typical Small System Operator has approximately 200 franchises serving a total of 52,335 subscribers (an average of 261 subscribers per franchise). The costs of negotiating, tracking and ensuring compliance with these various agreements are substantial compared with the cost of a single franchise agreement required for a given metropolitan area system serving a large number of subscribers.

If multiple small system owners have any advantage over independent, stand-alone systems is more efficient centralized management, a characteristic that the Small System Operators believe is absolutely essential to the continued provision of quality programming to very low density areas. For technically integrated systems with less than 1,000 subscribers, the average Small System Operator provides 24.5 channels to 347 subscribers. To maintain -- and expand -- this level of service to low-density areas, it will be necessary in the future to continue to streamline the management of small systems by further consolidation of management. Operators of multiple small systems should not be penalized for improving the efficiency of their operations in this way.

But, while operators of multiple small systems have been able to improve the efficiency of their operations through consolidation, the substantial programming discounts and leverage for financing that is generally available to large MSOs is not available to smaller MSOs. Even though the terms of programming contracts are confidential, it is generally believed by the Small System Operators that substantial programming discounts occur when an MSO has more than one million subscribers. Needless to say, these substantial discounts are not available to any of the 22 Small System Operators, which <u>together</u> serve about 1.3 million subscribers. The same also extends to financial leverage. Small system MSOs probably have more leverage to obtain financing than independently owned, stand-alone systems, but the financing terms that are available to small system MSOs are on a different scale than those available to large MSOs. The very strict loan covenants imposed on all small system operators alone warrant different treatment for small systems under the FCC's rate regulations. Specifically, debt-to-cash flow ratios in loan agreements are much more conservative for small MSOs. Because they benefit from neither the substantial programming discounts nor the financial leverage enjoyed by the large MSOs, and they suffer even greater administrative burdens and costs than independently-owned small systems, small system MSOs must be classified as "small systems" for purposes of rate regulation.

V. SMALL SYSTEMS SHOULD BE DEFINED BASED ON THE NUMBER OF SUBSCRIBERS PER FRANCHISE AREA, NOT THE NUMBER OF SUBSCRIBERS PER TECHNICALLY INTEGRATED SYSTEM

The cable television industry is evolving in two important ways that the FCC cannot ignore. First, the ownership of clusters of systems, rather than single, stand-alone systems, provides efficiencies that enable cable operators to extend service to low density areas and maintain quality programming on those systems. This consolidation of system ownership is critical to the industry's ability to provide service to low density areas, particularly in the face of heavy regulatory burdens.

Second, the entire cable television industry is moving in the direction of interconnection. Many operators have already embarked on the process of installing fiber optic links to interconnect their systems. Interconnection saves headend costs at the local level and serves the ultimate goal of developing a nationwide information superhighway. Ultimately, interconnection will lead to the same level of service in outlying rural areas as metropolitan areas, including programming choices and interactivity.

If the FCC were to measure system size based on the number of subscribers to a technically integrated system, this would provide a strong disincentive to the continued consolidation of ownership and technical interconnection that is already underway. Indeed, it would drive operators to splinter systems, promoting inefficiency and outdated technology. Instead of adopting a definition that will stifle growth and innovation, the Coalition urges the Commission to define "small system" based on the number of subscribers in a given franchise area. A definition based on franchise area will properly distinguish those small systems that are serving low density rural areas, without penalizing systems for maximizing efficiency and preparing for the future by consolidating and interconnecting systems. 3/

3/ The National Telephone Cooperative Association ("NTCA") in its cost-of-service comments in the instant proceeding correctly observed that the Commission's proposal to measure system size based on the number of subscribers served by the technically integrated system rather than the number of subscribers in a franchise area will penalize

[Footnote continued]